



IN REPLY REFER TO:  
CMS-AP00-03474

HONOLULU AUTHORITY for RAPID TRANSPORTATION

Andrew S. Robbins  
EXECUTIVE DIRECTOR AND CEO

Krishniah N. Murthy  
SENIOR ADVISOR

April 25, 2019

BOARD OF DIRECTORS

Damien T.K. Kim  
CHAIR

Terrence M. Lee  
VICE CHAIR

VIA EMAIL:  
lao.auditors@hawaii.gov

Mr. Leslie H. Kondo, State Auditor  
Office of the Auditor  
State of Hawaii  
465 S. King Street, Room 500  
Honolulu, Hawaii 96813-2917

Michele Chun Brunngraber  
Jade Butay  
John Henry Felix  
Wes Frysztacki  
Kamani Kuala'au  
Wesley K. Machida  
Tobias Martyn  
Glenn M. Nohara  
Ember Shinn  
Kathy Sokugawa  
Hoyt H. Zia

Dear Mr. Kondo:

Subject: Audit of the Honolulu Authority for Rapid Transportation (HART) – Part 4

Enclosed is HART's Response dated April 22, 2019, which does not include comments from the HART Board of Directors, to the Draft Audit Report Part 4 prepared by Baker Tilly Virchow Krause, LLP (Baker Tilly). Please include these comments and the disclosure when you issue your Final Report. HART looks forward to receiving your recommendations associated with this report and providing comments, if any, as we have been able to do with your draft audit report.

Following the HART Board review, HART may resubmit its comments based on any input from the Board.

Should you have any questions to our Response, please feel free to contact me directly.

Very truly yours,

Andrew S. Robbins  
Executive Director and CEO

Attachments

cc: HART Board of Directors

Mr. Leslie H. Kondo  
Page 2  
April 25, 2019

HART acknowledges the receipt of the Draft Audit Report Part 4 – Contract and Vendor Compliance Review Report.

Disclosure: HART's responses are subject to review after final Board review and may change based on action by the Board,

**Observation 1** - HART incurred additional labor costs of \$123,957. Lea + Elliot, Inc., (Lea + Elliot) submitted a billing rate reduction as a result of their overhead audit that would have resulted in project cost savings of \$21,302 and \$102,655 over the billing periods of January 1, 2015 through December 31, 2015 and January 1, 2016 through December 31, 2016, respectively. HART assessed the savings and determined it was below their materiality threshold of 3% and directed Lea + Elliott, Inc. to leave the billing rates unchanged, consequently incurring additional labor costs.

***HART's Response –***

In the evaluation of the 2015 audited OH rates, it was determined there would be a 0.35% savings (\$21,302) if the 2015 audited OH rates were incorporated into the contract. The then-head of Contract Administration incorrectly understood there to be a policy allowing for a waiver in the case of less than or equal 3% difference in the provisional and audited OH rates and, accordingly, waived the 0.35% difference. This was formalized in Amendment 1 to the contract, executed on Mar. 9, 2017. Since then, HART is in receipt of the 2016 and 2017 audited OH rates. The 2016 audited OH rate is 1.71% less than the 2015 audited OH rate, which would result in a savings of \$102,655. The 2017 audited OH rate results in another saving to HART of \$34,312. Both the 2016 and 2017 audited OH rates will be reconciled in the next Amendment to the contract. There was and is no “waiver” threshold policy at HART and HART has reinstated the HART (and federal) requirement to reconcile the prior year’s payment amounts with the audited OH rate. Under the new HART organization chart where Contract Administration is no longer a separate division, but now falls under the umbrella of Procurement, Contract Administration, and Construction Claims, there is more check and balance and senior-level oversight. Further, training will be provided to the contract administrators.

HART appreciates this observation by the State Auditor; as a result, L&E has agreed to reconcile the 2015 OH rate as well and the \$21,302 will be credited back to HART. Furthermore, HART will do a review of the prior years (prior to 2015) and reconcile the contract using the audited OH amounts, if discrepancies are found.

**Observation 2** - Labor rate contract administration is not performed annually. HART issues contract amendments to the seven cost-plus-fixed-fee contractors notifying them of the current billing rates for the upcoming 12 months. Based on the contract amendment dates, HART is not amending four of their seven contracts annually. Furthermore, some amendments are retroactively applied for as many as 24 months and others proactively applied for the next 12 months. The four contracts are valued at \$233,031,057.

***HART's Response -***

Each year, the overhead is audited by a certified independent auditor and payment made under the contract is reconciled as additional payment to the contractor or credit to HART.

Each cost plus fixed fee (CPFF) contract has negotiated labor rates with negotiated annual escalation. As per the contract, the escalated rates are used plus the most recent audited overhead rate to calculate the years fully burdened rate. The audited overhead rate is applied retroactively, because the audit is not conducted until after the firm's fiscal year is completed. The process of reconciling rates retroactively after receipt of the audited overhead rate is prescribed by the FTA. The length of time the firms take to audit their overhead varies from approximately 9 months to 18 months; therefore, the variation in "annual" contract amendment reconciliation/notification.

It is the responsibility, under the terms of the contract, for the contractor to use the newly calculated fully burdened rate going forward (or, "proactively") when submitting their invoices until the subsequent years audited overhead is completed. HART's contract manager checks whether the invoices include the newly calculated rate.

As indicated above, the length of time for consultant firms to provide their certified overhead audit is between 9 and 18 months and HART recognizes that each firm has its own business process timelines. The timing of the receipt of the audited OH rates has never been raised as an issue in FTA reviews. However, we will take the State Auditor's observation under advisement and inquire with the consultant firms as to the firm's ability to provide the certified audited overhead rate within 6 months from the end of the firm's fiscal year.

**Observation 3** - HDR Engineering, Inc. applied incorrect labor billing rates and overcharged HART \$5,143. During the test period of July 1, 2016 through June 30, 2018, Baker Tilly tested 100 labor transactions and discovered 12 labor rate billing errors, or a 12% error rate. The overcharge of \$5,143 is 0.12% of tested invoice value of \$4,165,946.

***HART's Response -***

HART is in the process of seeking reimbursement from HDR on the incorrect rates and vetting additional procedures to mitigate discrepancies.

**Observation 4** - HART does not require contractors to collect lien waivers. This is a deficiency in HART's contract administration program and potentially exposes HART to future subcontractor claims. The lien waiver provides proof to HART that the contractor has paid the subcontractor and the subcontractor does not have the right to ask HART for payment again for the work performed.

Mr. Leslie H. Kondo  
Page 4  
April 25, 2019

***HART's Response -***

HART's contracts are in compliance with federal requirements and the Hawaii Public Procurement Code, which do not require a lien waiver in HART's contracts. This notwithstanding, HART will take this observation under advisement and conduct an evaluation of the lien waiver with regard to mitigating HART's potential exposure to subcontractor claims.

**Observation 5** - HART does not require contractors and consultants to provide certificates of insurance (COI). COI is documentation proving that the contractor has the contractually required insurance coverage in place. Furthermore, this is a project cost that HART is paying for and, therefore, should verify that the coverage they are paying for is actually in place.

***HART's response -***

Submission of a Certificate of Insurance is required in all of HART's contracts. The COI requirement provision for each of the contracts reviewed by the State Auditor and the COI submitted by the contractor with the signing of the contract have been provided to the Baker Tilly. HART can provide the subsequent COIs upon request.

**Observation 6** - HART does not require Hawaiian Electric Company, Inc., (HECO) to provide overhead cost supporting documentation. HART reimburses Hawaiian Electric Company, Inc. 100% of their costs incurred. Documentation is provided for labor costs and field expenses; no documentation is provided for the allocated overhead cost billed to HART, as is required by other cost reimbursable contracts. Consequently, HART cannot verify that the overhead charges represent a cost-only reimbursement, and do not include any profit markup.

***HART's response -***

HART will work with HECO to seek further clarification on its overhead costs.

**Observation 7** - HART does not verify that contractors pay subcontractors within ten days of receiving payment from HART. This is not a risk to HART, however, it is a gap in the contract administration procedures.

***HART's response -***

While it is the contractor's responsibility under the contract to promptly pay its subcontractors within ten days of receiving payment from HART, HART is considering mechanisms by which to verify that the subcontractor is paid within the statutory timeline.

**Observation 8** - HART does not require on-call contractors and subcontractors to use a consistent overhead and profit markup. Task orders issued under the Royal Contracting Co., Ltd contracts (On-Call Contracts III, IV, V, and VI) may have different overhead and profit markup for the same work from the same contractor or subcontractor.

Mr. Leslie H. Kondo  
Page 5  
April 25, 2019

***HART's Response –***

Task Orders are essentially individual “contracts” based on the base contract issued under an IDIQ agreement. As such, each Task Order is evaluated separately for risk; the profit margin will vary for each Task Order depending on the level of risk to the contractor for work under the particular Task Order. For instance, the On Call contractor has no mark up on equipment. Labor overhead rates remain consistent for the On-call Contractor; pursuant to the pricing submitted under competitive procurement and is a part of the awarded contract. Under Hawaii Administrative Rules, up to 10% markup is allowed for the contractor for any work performed by its subcontractor, which HART also evaluates on a Task Order basis.

HART takes a prudent approach to mark ups by evaluating the mark up based on the Task Order. Lower mark ups are agreed with the On Call contractor on a Task Order basis. This approach allows overall costs of the work by Task order to be both fair and reasonable to the contractor as well as fair and reasonable to HART and the tax payer dollars that are received to pay for the work.

**Observation 9** - HART uses undocumented procedures for verifying contractor's invoices for cost-plus-fixed fee contracts. HART has implemented procedures that are not documented in the internal controls documentation. The lack of documentation may result in lost institutional knowledge and difficulty training new invoice review personnel.

***HART's Response –***

HART has in place a Consultant Invoice Payment Procedure which sets forth internal controls documentation and roles and responsibilities; invoice reviews are in accordance with these procedures. HART agrees that, in practice, HART has additional controls and best practices in place, which should be acknowledged, and further, added into the Invoice Payment Procedure.

Mr. Leslie H. Kondo

Page 6

April 25, 2019

**Observation 10** - The HART Core Systems Group has developed a process for tracking equipment or materials stored off-site, which HART has not documented in its internal controls manuals. HART should update the internal control manuals for new or improved controls to provide guidance for HART personnel to use on all projects.

***HART's response*** -

HART will put in place a written process to track the stored materials off site as part of an internal controls manual. This will be planned to be completed by the end of the second quarter.

**Observation 11** - HART has not audited the participants of the owner-controlled insurance program (OCIP) for compliance with the OCIP program. HART provides participating contractors with worker's compensation, business risk, and other insurance coverage. The participating contractors must exclude the cost of this insurance from their billings to HART. HART should exercise its right to audit the program and verify they are not double paying for insurance costs.

***HART's response*** -

The OCIP program applies to construction contracts only, which are (1) competitively procured and (2) are firm-fixed-price (FFP) contracts. Under a FFP contract, HART/government cannot "re-price" the contract. (Federal Acquisitions Regulations 16.202 on firm-fixed-price contracts is helpful in understanding a FFP contract.)